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INFO RUEHXC/ALL US CONSULATES IN MEXICO COLLECTIVE

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SENSITIVE

SIPDIS

STATE FOR WHA/MEX, WHA/EPSC

STATE FOR EB/ESC McMANUS AND DUGGAN

USDOC FOR 4320/ITA/MAC/WH/ONAFTA/GWORD

USDOC FOR ITS/TD/ENERGY DIVISION

TREASURY FOR IA (ALICE FAIBISHENKO)

DOE FOR INTL AFFAIRS ALOCKWOOD, GWARD AND RDAVIS

DOI FOR MMS ORR, TEXTORIS AND KARL

E.O. 12958: N/A

TAGS: [ENRG](#) [EPET](#) [ECON](#) [PGOV](#) [MX](#)

SUBJECT: ENERGY REFORM - WAITING TO READ THE FINE PRINT

REF: A. Mexico 3210

[B.](#) Mexico 2335

[C.](#) Mexico 1339

[D.](#) Mexico 531

[¶11.](#) (SBU) Summary: The energy reform package approved by the Mexican Congress in late October is complex - and in some areas vague. Many experts are waiting to see the bylaws and new contract templates before making a final judgment on what impact the legislation will have. In the meantime, the Ministry of Energy (SENER) and the state owned oil company, PEMEX, not surprisingly, are spinning a positive picture. The GOM highlights the political significance of a reform on this sensitive topic while claiming that the changes in the law will allow Mexico to attract more private sector interest and increase production of hydrocarbons. Many companies and analysts are still evaluating the results, but do not have high hopes about increased business opportunities. Publicly international oil companies (IOCs) are careful not to seem overly negative. They conclude that eventually Mexican will have no choice but to introduce deeper reforms, and they want to be in a good position to take advantage of the opportunities that arise. End Summary

[¶12.](#) (U) In a series of meetings over the past month, Econoff discussed the potential impact of the energy reform legislation approved by the Mexican Congress October 26 with SENER, PEMEX, representatives of international oil companies (IOCs), energy consultants, attorneys and journalists.

A HISTORIC ACHIEVEMENT - BUT DETAILS NEED TO BE DEVELOPED

[¶13.](#) (SBU) Officials from SENER and PEMEX are pleased with the result of the energy reform, and especially stress the political significance of this achievement. The fact that the three principal political parties in Congress acknowledged the need to reform this sensitive sector - long a taboo on the Mexican political scene - was in itself historic. GOM officials praise the ruling PAN and opposition PRI and PRD parties for working quietly together to forge an agreement. The final round of negotiations between the parties was conducted behind closed doors and away from media scrutiny.

[¶14.](#) (SBU) While acknowledging that the legislation sets limitations, both SENER and PEMEX officials believe the legal framework gives them enough flexibility to offer incentives that will attract IOCS -- especially to deepwater exploration and production. SENER and PEMEX are in the process of drafting the necessary bylaws and contract template. Some officials claim that these documents will be ready by September 2009, but most agree that the first tenders will not appear until late 2009 or early 2010. PEMEX has reached out to other international and state owned oil companies - especially Petrobras and Statoil - for advice on drafting the contracts and running the bidding process.

¶15. (SBU) Officials stress that the reform gives PEMEX greater operational flexibility in contracting goods and services. In particular, PEMEX plans to auction off blocks for both exploration and production. This will allow the firm that wins the bid to manage the full project. The law stipulates that PEMEX will make decisions about where drilling will take place, but PEMEX officials argue that such decisions would be made in collaboration with the company that holds the lease for a particular location. PEMEX officials note that the leases will be significantly larger than those offered in the U.S. by the Minerals Management Service of the Department of the Interior (MMS). The GOM is in the process of establishing the rules and procedure for an auction. (Note: The GOM has an open invitation from the MMS to view how the U.S. manages this process. End Note)

¶16. (SBU) PEMEX officials note that the GOM will begin with a small offering of blocks in areas near existing infrastructure. One official noted that PEMEX will start with a few leases to test how attractive the new contracts will be to the private sector, adding "We'll know pretty soon." GOM officials stressed that the new contracts should improve operational efficiency by including incentives for firms to use cutting edge technology. Variable compensation schemes under the new contracts will encourage faster and better results. Under the current system, several officials have complained that service companies use obsolete technology in Mexico and complete projects even if they know halfway through the contract that wells have little production promise.

¶17. (SBU) Both SENER and PEMEX officials stress the structural changes in the reform will make both organizations more effective and more efficient. According to SENER the legislation will strengthen the Energy Ministry and allow it to act as a buffer between the Finance Ministry and PEMEX. The newly created Hydrocarbons Council under SENER will give the Energy Ministry

MEXICO 00003491 002 OF 002

authority to set the oil production and reserves policy - a function currently under the Finance Ministry. PEMEX also stresses that changes to its organizational structure will allow the parastatal to operate more transparently and efficiently. Most experts agree, however, that the impact of these organizational changes will depend largely on finding individuals with the required technical skills to manage the Hydrocarbons Council and to fill the four new seats on the PEMEX board. Mexico has a shortage of qualified experts who could be brought into these key positions.

FLEXIBILITY ON TRANSBOUNDARY

¶18. (SBU) Both PEMEX and SENER officials told Econoff that the energy reform will allow more flexibility on exploiting potential transboundary reserves. According to the GOM interpretation, since not all the oil resources in a transboundary field belong to Mexico, the constitution would not prohibit PEMEX from entering into a joint venture with an IOC. The reform provides that transboundary fields would be exploited in accordance with the provisions of a bilateral treaty that has been ratified by the Mexican Senate. The Chamber of Deputies, which would be more critical of such provisions, would not have jurisdiction. PEMEX added that their intention on potential U.S.-Mexico transboundary fields would be to collaborate closely with the companies and use the infrastructure on the U.S. side of the boundary. (Note: This is a sensitive issue in Mexico, and would almost certainly be challenged in court by opponents of a more open energy regime. End Note.)

PRIVATE SECTOR - TOO EARLY TO SAY

¶19. (SBU) The IOCs do not share the GOMs effusive praise for the energy reform legislation. However, they are also cautious not to criticize the energy reform package publicly. The IOCs recognize that the Calderon Administration, Mexican Senate and Chamber of Deputies have put a significant effort into the reform process. They are also aware that, by working with SENER and PEMEX during the drafting stages, they may be able to shape somewhat the terms of the new contracts. For now, the private sector is waiting to see the bylaws and contracts to determine if they will provide for any additional business opportunities.

¶10. (SBU) More IOCs may decide to pursue service contracts even if the terms are not significantly better than the current model. Petrobras and Repsol already work with PEMEX under existing contracts. Other IOCs may decide that it is better to develop a close cooperative relationship with PEMEX now which could prove useful when Mexico opens its energy sector. These firms may also be

interested in selling technology even if they cannot share production. Still, IOCs have limited resources and the new service contracts may not be lucrative enough to make doing business in Mexico a priority.

¶11. (SBU) GOM officials and industry experts expect the constitutionality of the reform will be challenged through the first round of contracts. While government officials and industry experts agree that such a challenge will create legal certainty, the downside is that no company will want to be the one embroiled in the legal battle. The IOCs will take into account that firms which take advantage of the new service contracts may find themselves under a political spotlight and could be subject to negative public backlash.

COMMENT:

¶12. (SBU) Although many companies and analysts are waiting to see the bylaws and new contract model before deciding on the value of the GOM's energy reform package, most are privately cynical about how much the reform will do to expand business opportunities. The IOCs have been mindful of the political significance of the reform and cautious not to seem too critical of the results. In particular, the IOCs with a presence in Mexico are here for the long haul and calculate if (and when) this reform fails to turn around production, the Mexican Congress will have no choice but to introduce deeper reforms. International oil companies want to make sure that they are well positioned when that happens.

GARZA